719

No. 05-1429

FILED
DEC 22 2006
OFFICE OF THE CLERK
SUPREME COURT, U.S.

IN THE

Supreme Court of the United States

TRAVELERS CASUALTY & SURETY COMPANY OF AMERICA,

Petitioner,

—v.—

PACIFIC GAS AND ELECTRIC COMPANY,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF IN SUPPORT OF RESPONDENT FOR *AMICI CURIAE* PROFESSORS RICHARD AARON, JAGDEEP S. BHANDARI, SUSAN BLOCK-LIEB, RALPH BRUBAKER, ERWIN CHEMERINSKY, S. ELIZABETH GIBSON, KENNETH N. KLEE, ROBERT M. LAWLESS, NANCY B. RAPOPORT AND ETTIE WARD

ROBERT M. ZINMAN
Professor of Law
ST. JOHN'S UNIVERSITY
SCHOOL OF LAW
8000 Utopia Parkway
Jamaica, New York 11439
(718) 990-6646/(914) 631-3515

Counsel of Record
for Amici Curiae

December 22, 2006

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES iii

INTEREST OF *AMICI CURIAE* 1

SUMMARY OF ARGUMENT 2

ARGUMENT 6

I. Bankruptcy Code § 502(b) Should Be Construed Narrowly In Light Of Long-Standing Precedent Of This Court, and The Structure and Goals Of The Bankruptcy Code 6

A. In Light of Other Bankruptcy Code Provisions, § 502(b) Should Be Narrowly Construed Not To Allow Unsecured Creditors' Claims For Postpetition Legal Services of No Benefit to The Estate 6

B. *Timbers of Inwood* Supports Disallowance of Contractual Postpetition Fee Claims For Unsecured Creditors 7

C. Under *Randolph v. Scruggs* and Other Cases, Unsecured Creditors Should Be Allowed Claims For Postpetition Legal Fees Only If The Attorney's Services Were Beneficial To The Estate. 9

D. The Bankruptcy Courts Have Exclusive Jurisdiction Over Legal Fees In Bankruptcy Cases; Such Fees Are Not A Matter For Private Agreements 13

E. Section 502(b) Should Be Narrowly Construed In View of The Bankruptcy Code's Distinction Between the Prepetition and Postpetition Periods 14

F. Interpretation of § 502(b) In Light of the Principle of Equality of Distribution For Creditors 16

II. Congress Could Not Have Intended To Allow Unsecured Creditors' Contract Claims For Postpetition Legal Fees In Light of The Severe Adverse Consequences Such Allowance Would Have On The Administration of Chapter 11 and Chapter 13 Cases 18

A. Allowing Such Claims Would Cause Unwarranted Escalation of Monitoring Activities By Individual Creditors and Mounting Expense for the Estate 18

B. Allowing Postpetition Legal Fees to Unsecured Creditors Will Overly Complicate Chapter 11 Cases 21

C. Unsecured Creditors' Legal Fee Claims Should Not Be Allowed Because of the Serious Consequences Allowance Would Have on Chapter 13 Debtors and Their Unsecured Creditors 24

CONCLUSION 29

TABLE OF AUTHORITIES

FEDERAL CASES

In re 5900 Associate, Inc., 468 F.3d 326 (6th Cir. 2006) 14

Alport v. Ritter (In re Alport), 144 F.3d 1163 (8th Cir. 1988).....17

In re Alumni Hotel Corp., 203 B.R. 624 (Bankr. E.D. Mich. 1996) 12

Boeing Co. v. Van Gemert, 444 U.S. 472 (1980).....10

Boese v. King, 108 U.S. 379 (1883).....16

Matter of Brints Cotton Marketing, Inc., 737 F.2d 1338 (5th Cir. 1984).....15

In re Brown, 346 B.R. 868 (Bankr. N.D. Fla. 2006).....26

Brown v. Gerdes, 321 U.S. 178 (1944).....14

Burlingham v. Crouse, 228 U.S. 459 (1913) 27

Clarke v. Rogers, 228 U.S. 534 (1913).....16

In re Combustion Engineering, Inc., 391 F.3d 190 (3d Cir. 2004).....20

Matter of Consolidated Bancshares, Inc., 785 F.2d 1249 (5th Cir. 1986).....11

Davidson v. Davidson (In re Davidson), 947 F.2d 1294 (5th Cir. 1991).....17

Dewsnup v. Timm, 502 U.S. 410 (1992) 11

Dunbar v. Dunbar, 190 U.S. 340 (1903) 22

In re Ezell, 338 B.R. 330 (Bankr. E.D. Tenn. 2006) 26

In re Fleming, 339 B.R. 716 (Bankr. E.d. Mo. 2006) 26

In re Fobian, 951 F.2d 1149 (9th Cir. 1991) 2

In re Friedman, 232 F.3d 151 (2d Cir. 1956) 11

In re Fuger, 347 B.R. 94 (Bankr. D. Utah 2006) 27

In re Fuller, 346 B.R. 472 (Bankr. S.D. Ill. 2006) 27

In re Granite Partners, L.P., 213 B.R. 440 (Bankr. S.D.N.Y. 1997) 12

Guerin v. Weil, Gotshal & Manges, 205 F.2d 302 (2d Cir. 1953) 11

In re Gulf Hills Development Corp., 60 B.R. 366 (S.D. Miss. 1985) 14

Hensley v. Eckerhart, 461 U.S.424 (1983) 23

In re Inslaw, 106 B.R. 331 (Bankr. D.C. 1989) 14

Internal Importation Fund Trustees v. Greenough, 105 U.S. 527 (1881) 10

In re Johnson, 337 B.R. 269 (Bankr. M.D.N.C. 2006) 26

Jordan v. Southeast National Bank, 927 F.2d 221 (5th Cir. 1991) 17

In re Kisselberth, 273 F.3d 714 (6th Cir. 2001).....14

Lebron v. Mechem Financial, Inc., 27 F.3d 937 (3d Cir. 1994).....12

Leiman v. Gutman, 336 U.S. 1 (1949).....13, 14

In re Lister, 846 F.2d 55 (10th Cir. 1988).....11

Local Loan Co. v. Hunt, 292 U.S. 234 (1934).....27

Martin v. Bank of Germantown (In re Martin), 761 F.2d 1163 (6th Cir. 1985).....17

In re Meza, 467 F.3d 874 (5th Cir. 2006).....27

Midlantic National Bank v. New Jersey Department of Environmental Protection, 474 U.S. 949 (1986).....11

Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970).....10

New Haven Inclusion Cases, 399 U.S. 392 (1970).....13

In re Nova Real Estate Investment Trust, 23 B.R. 62 (Bankr. D. Va. 1982).....22

Official Committee of Cybergenics, 330 F.3d 548 (3d Cir. 2003).....12

In re Omigas Group, Inc., 16 F.3d 1443 6th Cir. 1994).....3

Pepper v. Litton, 308 U.S. 295 (1939).....18

Randolph v. Scruggs, 190 U.S. 533 (1903).....2, 9, 10 11, 12

Ruckelshaus v. Sierra Club, 463 U.S. 680 (1983).....20, 21

In re Sakowitz, Inc., 110 B.R. 268
(Bankr. S.D. Tex. 1989).....15, 19

Saper v. John Viviane & Sons, Inc., 258 F.2d 826
(2d Cir. 1958).....11

Matter of Saphire Steamship Lines, Inc., 509 F.2d 1242
(2d Cir. 1975).....11

Sexton v. Dreyfus, 219 U.S. 339 (1911).....14, 15, 16

In re Sokolowski, 205 F.3d 532 (2d Cir. 2000).....10

In re Solar Manufacturing Corp., 206 F.2d 780
(3d Cir. 1953).....11

In re Southern Pacific Funding Corp., 268 F.3d 712
(9th Cir. 2001).....13

Tennessee Student Assistance Corp. v. Hood,
541 U.S. 440 (2004).....13

Transouth Finance Corp. of Fla. v. Johnson ,
931 F.2d 1505 (11th Cir. 1991) 17

In re Triangle Laboratories, Inc., 663 F.2d 463
(3d Cir. 1981).....13

Union Bank v. Wolas, 502 U.S. 151 (1991).....16

In re United Merchants & Manufacturers, Inc.,
774 F.2d 134 (2d Cir. 1982).....10

*United Savings Association of Texas v.Timbers of Inwood
Forest Associate, Ltd.*, 484 U.S. 365 (1988).....7, 8, 17

Vizcaino v. Microsoft Corp., 290 F.3d 1043 (9th Cir.), cert denied 537 U.S. 1018 (2002) 10

In re Wilson, 274 B.R. 4 (Bankr. D.C. 2001) 25

Worthen Bank & Trust Co. v. Morris (In re Morris), 602 F.2d 826 (8th Cir. 1979) 17

Young v. Higbee, 324 U.S. 204 (1945) 16

FEDERAL STATUTES

11 U.S.C. §101 et seq.....2

Bankruptcy Code § 101(5).....22

Bankruptcy Code § 101(10).....15

Bankruptcy Code § 103(a).....24

Bankruptcy Code § 301(5).....15

Bankruptcy Code § 303(h).....15

Bankruptcy Code § 303(i).....6

Bankruptcy Code § 330 6

Bankruptcy Code § 331 6

Bankruptcy Code § 362(d).....20

Bankruptcy Code § 362(d)(1) 7, 8

Bankruptcy Code § 362(k).....6

Bankruptcy Code § 363(b).....20

Bankruptcy Code § 364 20

Bankruptcy Code § 365 20

Bankruptcy Code § 502(b) ..... *passim*

Bankruptcy Code § 502(c) 5, 22

Bankruptcy Code § 503(b) ..... *passim*

Bankruptcy Code § 503(b)(3)(D) and (4) ..... *passim*

Bankruptcy Code § 506 ..... *passim*

Bankruptcy Code § 506(b) ..... *passim*

Bankruptcy Code § 523(a) 17

Bankruptcy Code § 523(d) 6

Bankruptcy Code § 1104 20

Bankruptcy Code § 1113 20

Bankruptcy Code § 1114 20

Bankruptcy Code § 1121(d) 20

Bankruptcy Code § 1123(a)(4) 16

Bankruptcy Code § 1125 ..... 20, 23

Bankruptcy Code § 1129 20

Bankruptcy Code § 1322(d) 25

Bankruptcy Code § 1325(a) 26

Bankruptcy Code § 1325(a)(5)(B) 26

Bankruptcy Code § 1325(a)(9) 26

Bankruptcy Code § 1325(b)(1)(B) 24

Bankruptcy Code § 1325(b)(2) 24

Bankruptcy Code § 1326(c) 25

28 U.S.C. § 1334(e) 13

CONGRESSIONAL HISTORY

S. Rep. 95-989, 95th Cong., 2d Sess. 40 (1978) 14

OTHER AUTHORITY

Liore Z. Alroy and J. Michael Mayerfeld, *Contracted-For Post-Petition Attorneys' Fees and Collection Costs; United Merchants Revisited*, 1992 Colum. Bus. L. Rev. 309, 321-23 8

Kenneth N. Klee and K. John Shaffer, *Creditors' Committees Under Chapter 11 of the Bankruptcy Code*, 44 S. Carolina L. Rev. 995, 997 (1993) 19

Keith M. Lundin, *Chapter 13 Bankruptcy* § 518.1 (3d ed. 2006) 26

INTEREST OF *AMICI CURIAE*[1]

The *Amici Curiae* are law professors who have devoted their careers to the study and teaching of bankruptcy law.[2] They respectfully submit this *pro bono* brief in support of Respondent.

The *Amici* are deeply interested in this case because of the severe adverse impact the allowance of postpetition legal fees to unsecured creditors in a bankruptcy case could have on the sound and economical administration of the case. They file this brief to offer to the Court what assistance they can as it considers and decides whether to allow an unsecured creditor, based on a contract clause it obtained from the debtor before the bankruptcy filing, to charge the debtor estate for the legal fees it incurs for its attorney to monitor and appear in proceedings in the debtor's bankruptcy case for the sole benefit of such creditor.

---

[1] Pursuant to Rule 37 of the Rules of this Court, the *Amici* file this brief with the written consent of both parties, which are on file with the Clerk. No counsel for a party authored this brief in whole or in part. No person or entity including the *Amici* or their counsel made a monetary contribution for the preparation or submission of this brief.

[2] The *Amici* are Richard Aaron, Professor of Law, S. J. Quinney College of Law, University of Utah; Jagdeep S. Bhandari, Professor of Law, Florida Coastal School of Law; Susan Block-Lieb, Professor of Law, Fordham Law School; Ralph Brubaker, Professor of Law and Mildred Van Voorhis Jones Faculty Scholar, University of Illinois College of Law; Erwin Chemerinsky, Alston & Bird Professor of Law and Political Science, Duke University; S. Elizabeth Gibson, Burton Craige Professor of Law, University of North Carolina at Chapel Hill; Kenneth N. Klee, Professor of Law, University of California at Los Angeles School of Law; Robert M. Lawless, Gordon & Silver, Ltd. Professor of Law, William S. Boyd School of Law, University of Nevada, Las Vegas; Nancy B. Rapoport, Professor of Law, University of Houston Law Center; and Ettie Ward, Professor of Law, St. John's University School of Law.

In the *Amici's* view, an unsecured creditor who has provided no benefit to the estate should not be permitted to shift its postpetition legal fees to all of the other creditors who enjoyed no benefit from the legal services such creditor chose to obtain for its own purposes. This brief argues that, in the absence of benefit to the estate, the allowance of such fees would be at odds with long-standing precedent of this Court and the fundamental bankruptcy goal of equality for creditors, and impair the sound administration of chapter 11 and chapter 13 cases.

SUMMARY OF ARGUMENT

The *Amici* seek an affirmance of the order of the Court of Appeals for the Ninth Circuit disallowing Petitioner's claim for the legal fees it incurred for monitoring and appearing in various proceedings in the Respondent's case for reorganization under chapter 11 of the Bankruptcy Code.[3] But the *Amici* urge disallowance on a *different* basis than the one employed by that court. In this case, the Ninth Circuit applied its decision in *In re Fobian*, 951 F.2d 1149 (9th Cir. 1991), which disallowed an unsecured creditor's claim for postpetition legal fees because its fees were incurred for litigating purely *bankruptcy* law issues. The *Amici* contend, however, that *none* of the postpetition legal fees incurred by an unsecured creditor should be allowed in the absence of a substantial benefit to the estate as a result of such legal services.

The *Amici* note a long-standing holding of this Court that an unsecured creditor's postpetition legal fees are allowed only for services that provide a benefit to the estate. *Randolph v. Scruggs*, 190 U.S. 533, 539 (1903) (per Holmes,

---

[3] The Bankruptcy Code is codified in 11 U.S.C §101 et seq., and is referred to herein as the Bankruptcy Code.

J.) (a claimant's pre-bankruptcy contract claim for postpetition legal services will be allowed only if they were "beneficial to the estate."). The *Amici* accordingly argue that § 502(b)[4] should be narrowly construed not to allow an unsecured creditor's claim for legal services that did not benefit the debtor estate.

This is a case in which one unsecured creditor seeks to gain more on its claim in the bankruptcy than the other unsecured creditors by collecting its own postpetition legal fees from the debtor estate.[5] The charging of an unsecured creditor's legal fees to the estate, which received no benefit from the legal services, would, however, be at odds with the bankruptcy principle of equality for creditors. The allowance of such fees to an unsecured creditor who obtained a fee-shifting contract clause would prefer such claimant over other unsecured creditors, particularly those who become creditors *involuntarily*, such as tort creditors, the United States as the holder of various non-priority tax claims, and state and local tax creditors, who were never in a position to seek fee-shifting contracts. In addition, many trade creditors and others do not have the negotiating power to obtain such

---

[4] Citations in this form are to sections of the Bankruptcy Code.

[5] As stated in *In re Omigas Group, Inc.*, 16 F.3d 1443, 1445 (6th Cir. 1994), analogizing to the film, Annie Hall (United Artists Entertainment 1977):

> Understandably, creditors of bankrupt debtors often feel like restaurant patrons who not only hate the food, but think the portions are too small. [fn 1]. To press the analogy, they also don't like having to wait in line for a table, possibly being seated only to find out that the kitchen has just closed. The bankruptcy court is a little like a soup kitchen, ladling out whatever is available in ratable portions to those standing in line; nevertheless, scarcity begets innovation in the hungry creditor's quest to get a little more than the next fellow. This case involves just such an effort.

clauses, so that an unsecured creditor who obtained such a clause would be preferred over many other types of creditors as well.

The bankruptcy system would be overwhelmed with claims by unsecured creditors for legal fees if they are allowed to charge the estate for the fees of their attorneys to monitor all of the proceedings in the bankruptcy case, and to pursue unnecessary protections for their claims in proceedings in the case. The announcement of such a rule would be a wake-up call to creditors alerting them to write or revise their contract forms so as to shift to the estate all legal fees they may incur for services that relate in *any* way to a subsequent bankruptcy case of the other party. Such a rule could generate a multitude of legal fee claims by unsecured creditors in many bankruptcy cases, which would be duplicative of the legal fees borne by the estate for the services of the attorney for the statutorily designated official creditors' committee, which performs its statutory duties and functions on behalf of the entire creditor body.

Moreover, a ruling that allows postpetition legal fees for services to an unsecured creditor that did not benefit the estate would cause severe adverse consequences in chapter 11 and chapter 13 cases. In light of the consequences of such a rule, as set forth herein, Congress could not have intended to obscure the allowance of such legal fee claims within the general language of § 502(b).

First, if the Court announces such a rule, it will alert all creditors to write broad fee shifting clauses, and the level of participation by unsecured creditors' attorneys will increase because the estate will bear the freight. Unsecured creditors' attorneys will monitor all proceedings in chapter 11 cases even though many, if not most, of them do not directly affect the particular rights of their creditor clients.

Second, allowing postpetition legal fees to an unsecured creditor will overly complicate chapter 11 cases. At the beginning of a chapter 11 case, the creditor would not know what legal services it will seek or the extent thereof. That will only become known in stages as the chapter 11 case progresses. Nevertheless, at the outset of a case, as in the present one, the creditor will file a "contingent" proof of claim in a particular amount, based solely on a guess. In due course, it will be necessary to quantify the claim, either by estimation pursuant to § 502(c), or by an adjudication in a litigated proceeding. Neither process, however is satisfactory. An estimation proceeding is a process leading to an educated guess by the bankruptcy court, which may turn out to be way off the mark, and the litigated approach may require more than one adjudication to determine the amount of the creditor's claim. This will consume the time of the court and the parties, and escalate the burden on the estate for fees, while reducing the "pot" available for the other unsecured creditors.

Third, the allowance of postpetition legal fee claims of unsecured creditors would have a significant adverse effect both on chapter 13 debtors and their unsecured creditors. This is of great concern because of the hundreds of thousands of chapter 13 cases filed each year. These adverse effects have come into sharp focus because of amendments to the Bankruptcy Code governing chapter 7 and chapter 13 adopted by Congress in 2005. The vast majority of workers use their own automobiles to get to and from their jobs. Under the amended provisions, for most chapter 13 debtors to avoid foreclosure of the purchase money lien on their cars and be able to retain them and enjoy a "fresh start," they must pay in cash to the secured party the full amount of the underlying debt. The allowance of legal fee claims would not only increase the amount of cash the debtor must come up with to keep the car, but also reduce *pro tanto* the amount of

the debtor's "disposable income" that the unsecured creditors will receive under a chapter 13 plan. Unsecured creditors' legal fee claims will also reduce the payments to the other creditors. Moreover, such a rule would require the periodic recomputation by the chapter 13 trustee of the amount of each creditor's distribution because of the ever-increasing amount of an unsecured creditor's postpetition legal fees. Such recomputation would have to be made in each case, usually monthly, by the standing chapter 13 trustee in the district, who may be responsible for administering thousands of chapter 13 cases, and would pose enormous administrative complications and difficulties in chapter 13 cases.

ARGUMENT

I. BANKRUPTCY CODE § 502(b) SHOULD BE CONSTRUED NARROWLY IN LIGHT OF LONG-STANDING PRECEDENT OF THIS COURT, AND THE STRUCTURE AND GOALS OF THE BANKRUPTCY CODE.

A. In Light of Other Bankruptcy Code Provisions, § 502(b) Should Be Narrowly Construed Not To Allow Unsecured Creditors' Claims For Postpetition Legal Services of No Benefit to The Estate

Section 502(b) should not be construed to allow an unsecured creditor's claim for legal fees because to do so would be contrary to the structure of the Bankruptcy Code, which has many provisions that explicitly provide for the allowance of postpetition legal fees in specific circumstances. See, e.g., §§ 303(i), 330, 331, 362(k), 503(b)(3)(D) and (4), 506(b), and 523(d).

Specifically, only two provisions of the Bankruptcy Code authorize a creditor's claim for postpetition legal fees,

and Petitioner's claim does not fit within either of them. The first is § 503(b)(4), which, in conjunction with § 503(b)(3)(D), authorizes a bankruptcy court to allow as an expense of administration of a chapter 11 case the postpetition legal fees of an attorney for an unsecured creditor in making a "substantial contribution" in the case. The second, § 506(b), allows the legal fees of a secured creditor, but only to the extent that the value of the collateral exceeds the principal and interest of the claim. Petitioner's claim fails to qualify under either of these provisions. In light of these provisions sharply limiting the recognition of claims for postpetition legal fees of creditors' attorneys, § 502(b) should be interpreted narrowly.

B. *Timbers of Inwood* Supports Disallowance of Contractual Postpetition Fee Claims For Unsecured Creditors

The Court's discussion of Bankruptcy Code § 362(d)(1) and § 506 in *United Savings Ass'n of Texas v. Timbers of Inwood Forest Assoc., Ltd.*, 484 U.S. 365 (1988), supports the conclusion that § 502(b) should be construed narrowly. There, the Petitioner, a secured creditor whose collateral was worth less than the amount of its claim, argued that it was entitled to periodic payments for the use value of its collateral under the "adequate protection" provision of § 362(d)(1). The Court first stated that § 362(d)(1) could be read to support Petitioner's claim, but rejected that reading because it was implausible to impute to Congress an intent to allow such claims under a general provision, rather than providing for them specifically in § 506(b). As analyzed by Justice Scalia for a unanimous court:

> If the Code had meant to give the undersecured creditor, who is thus denied interest on his *claim*, interest on the value of his *collateral*, surely

> [§ 506(b)] is where that disposition would have been set forth, and not obscured within the "adequate protection" provision of § 362(d)(1). Instead of the intricate phraseology set forth above, § 506(b) would simply have said that the secured creditor is entitled to interest "on his allowed claim, or on the value of the property securing his allowed claim, whichever is lesser."

Id. at 373 (Italics in original). The Court's logic in *Timbers of Inwood* likewise requires the disallowance of a contract claim for postpetition legal fees by an unsecured creditor who has provided no benefit to the estate. If Congress had intended to allow such claims despite the absence of benefit to the estate, it would have simply said so in any of the numerous provisions of the Bankruptcy Code that do authorize postpetition legal fees, and not silently "obscured" the allowance of such claims within the general language of § 502(b).

Moreover, the Court pointed out in *Timbers of Inwood* that § 506 has the "substantive effect of denying undersecured creditors postpetition interest on their claims" by not providing for it. 484 U.S. at 372. Section 506, which deals with attorneys' fees, as well as interest, should have the same substantive effect of disallowing postpetition attorneys' fees for undersecured creditors, and by extension for wholly unsecured creditors as well. See Liore Z. Alroy and J. Michael Mayerfeld, *Contracted-For Post-Petition Attorneys' Fees and Collection Costs; United Merchants Revisited*, 1992 Colum. Bus. L. Rev. 309, 321-23 ("Timbers suggests that attorneys' fees ought not to be allowed to anyone save an oversecured creditor with a contract providing for collection costs").

C. Under *Randolph v. Scruggs* and Other Cases, Unsecured Creditors Should Be Allowed Claims For Postpetition Legal Fees Only If The Attorney's Services Were Beneficial To The Estate.

Long ago, in *Randolph v. Scruggs*, 190 U.S. 533 (1903), this Court formulated the requirement of "benefit to the estate" for the allowance of unsecured creditors' contract claims for postpetition legal fees. As stated by Justice Holmes for the Court:

> We are not prepared to go further than to allow compensation for [legal] services which were *beneficial to the estate*.

190 U.S. at 539 (Italics added).

Randolph v Scruggs appears to be the only case in which this Court has ruled on the allowability in bankruptcy of a claimant's unsecured contract claim for postpetition legal fees it incurs during a bankruptcy case. In the *Amici's* view, *Randolph v. Scruggs* is controlling.

In *Randolph v. Scruggs*, an assignment for the benefit of creditors made by a debtor pursuant to state law was superseded by a subsequent involuntary bankruptcy filing. The pre-bankruptcy assignment contract between the debtor-assignor and the assignee provided for the payment of fees of the assignee's attorneys. Based on the prepetition contract clause for legal fees, the assignee's attorneys filed a claim against the bankruptcy estate for their fees for various services, including advice to the assignee with respect to his duties, and in resisting adjudication in bankruptcy of the debtor-assignor *during the bankruptcy case*. The Court held that the attorneys' contract claim for legal fees, including such claim for *postpetition* legal services, could be allowed

only if the legal services were beneficial to the bankruptcy estate, stating: "The services to the voluntary assignee may be allowed so far as they *benefited the estate.*" 190 U.S. at 539 (Italics added).

This Court thus held in *Randolph v. Scruggs* that the attorneys' services for resisting such adjudication during the bankruptcy case did not give rise to an allowable claim because they were of no benefit to the estate. With respect to the claim based on the attorneys' advice to the assignee, the Court ruled that a remand was necessary for factual findings as to whether such advice was beneficial to the estate. Petitioner does not pretend that any of the legal services of its attorneys were beneficial to the estate. Under *Randolph v. Scruggs*, its contract claim for postpetition legal fees must be disallowed.[6]

The doctrine for charging one party's legal fees to a group that benefited from them has its origin in *Internal Imp. Fund Trustees v. Greenough*, 105 U.S. 527, 531-32, 535-36 (1881), and has been applied ever since. See *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 392 (1970); *Boeing Co. v. Van Gemert*, 444 U.S. 472, 478 (1980); *Vizcaino v. Microsoft Corp.*, 290 F.3d 1043, 1051-52 (9th Cir.), cert denied 537 U.S. 1018 (2002).

---

[6] Petitioner's heavy reliance on the *dicta* of the Second Circuit in *In re United Merchants & Mfrs., Inc.*, 774 F.2d 134 (2d Cir.1982), a decision under the prior Bankruptcy Act offering the court's interpretation of then newly-enacted § 506(a) of the Bankruptcy Code, is entirely misplaced. Not only is that opinion *dicta* because § 506 was inapplicable, but also it is unlikely that the Second Circuit would currently hold that contract claims for such postpetition services may be allowed. See *In re Sokolowski*, 205 F.3d 532, 535 (2d Cir. 2000) (disallowing a claim for attorneys' fees).

The principle established by *Randolph v. Scruggs* has been adhered to by the courts. See *Saper v. John Viviane & Sons, Inc.*, 258 F.2d 826, 828 (2d Cir. 1958) ("[A]s a general rule no compensation or reimbursement can be had unless a tangible benefit has been conferred on the estate to the advantage of the creditors as a whole."); *In re Friedman*, 232 F.3d 151 (2d Cir. 1956); *In re Solar Mfg. Corp.*, 206 F.2d 780, 781 (3d Cir. 1953) (the work of attorneys for creditors "must be at the expense of their clients unless it is in some manner beneficial to the estate"); *Guerin v. Weil, Gotshal & Manges*, 205 F.2d 302, 304 (2d Cir.1953) (In the absence of benefit to the estate, "the bankruptcy court lacks power to grant, and the policy of the [Bankruptcy] Act is against, compensation not expressly provided for by the Act."); *Matter of Saphire Steamship Lines, Inc.*, 509 F.2d 1242, 1245 (2d Cir.1975); *Matter of Consol. Bancshares, Inc.*, 785 F.2d 1249, 1253 (5th Cir. 1986) ("[A] creditor's attorney must ordinarily look to its own client for payment, unless the creditor's attorney ... *conferred a significant and demonstrable benefit* to the debtor's estate and the creditors.") (Italics in original); *In re Lister*, 846 F.2d 55, 57 (10th Cir. 1988).

If Congress had intended, when enacting § 502(b) and § 506, to overturn *Randolph v. Scruggs* or the subsequent cases conditioning the allowance of an unsecured creditor's postpetition fee claim on benefit to the estate, it would have said so explicitly in either of those provisions or in their legislative history. See *Dewsnup v. Timm*, 502 U.S. 410, 419 (1992) ("When Congress amends the bankruptcy laws, it does not write on a clean slate [and] this Court has been reluctant to accept arguments that would interpret the Code ... to effect a major change in pre-Code practice that is not at least the subject of some discussion in the legislative history."). See also, *Midlantic Nat'l Bank v. New Jersey Dep't of Environmental Protection*, 474 U.S. 949, 501 (1986)

("[I]f Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific.").

The doctrine of *Randolph v. Scruggs* requiring benefit to the estate has been carried into the Bankruptcy Code in § 503(b)(3)(D) and (4), which allows legal fees to the attorney for an unsecured creditor who has made a "substantial contribution" in a chapter 11 case. Petitioner ignores this Code provision in its argument that Congress meant for postpetition legal fees to be payable whenever provided for by a contract clause. But the long-standing rule of *Randolph v. Scruggs*, which is carried into § 503(b)(3)(D) and (4), eviscerates Petitioner's argument. Something more is required of an unsecured creditor for it to grasp a disproportionate share of the bankruptcy estate – it must substantially contribute to that estate to recover its attorney's fees. See *Lebron v. Mechem Financial, Inc.* 27 F.3d 937, 944 (3d Cir. 1994) ("[T]he purpose of § 503(b)(3)(D) is to encourage activities that will benefit the estate as a whole...."). See also *Official Committee of Cybergenics*, 330 F.3d 548, 564 (3d Cir. 2003) (§ 503(b)(3)(D) and (4) continues the benefit policy of § 64(a)(1) of the former Bankruptcy Act allowing a creditor to recover expense incurred "which actually benefits the estate."). In addition, the courts have developed a stringent standard for the allowance of fee claims of attorneys for unsecured creditors pursuant to § 503(b)(3)(D) and (4). As stated in *Lebron, 27* F.3d at *944,* the applicable test for determining whether there has been a "substantial contribution" is whether the efforts of the applicant resulted in "an actual and demonstrable benefit to the debtor's estate [and] the creditors." Accord: *In re Granite Partners, L.P.*, 213 B.R. 440, 446 (Bankr. S.D.N.Y. 1997); *In re Alumni Hotel Corp.*, 203 B.R. 624, 632 (Bankr. E.D. Mich. 1996). In the present case, Petitioner does not

make any pretense that its attorneys' services provided any benefit whatever to the estate or the creditors.[7]

D. The Bankruptcy Courts Have Exclusive Jurisdiction Over Legal Fees In Bankruptcy Cases; Such Fees Are Not A Matter For Private Agreements

A fundamental principle of the bankruptcy law is that the bankruptcy courts have *exclusive* jurisdiction over the property of the debtor estate from the moment that the debtor's bankruptcy case has been commenced. See *New Haven Inclusion Cases*, 399 U.S. 392, 420-21 (1970). Such exclusive jurisdiction of the bankruptcy courts was carried into the 1978 bankruptcy jurisdictional legislation as 28 U.S.C. § 1334(e). See *Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440, 447 (2004) (relying on 28 U.S.C. § 1334(e)).

Among the matters central to bankruptcy that are within the exclusive jurisdiction of the bankruptcy courts is the conduct of litigation in those courts and the determination of issues regarding legal fees incurred in connection therewith. See *Leiman v. Gutman*, 336 U.S. 1, 9 (1949) ("...[T]he determination of [legal fee] allowances has been made an integral part of the process of confirmation which is

---

[7] To the extent that a contract clause triggers an obligation for postpetition legal fees because of a bankruptcy filing, it is in the nature of an *ipso facto* provision and should be held unenforceable for that reason as well. See §§ 365(e)(1) and 541(c)(1)(B); *In re Southern Pacific Funding Corp.*, 268 F.3d 712, 716 (9th Cir. 2001) (*ipso facto* provisions are intended "to protect the debtor from enforcement of unfavorable insolvency-triggered clauses"); *In re Triangle Lab., Inc.*, 663 F.2d 463, 465 (3d Cir. 1981) (Congress outlawed *ipso facto* clauses under the Bankruptcy Code to protect and maximize the estate, indicating a strong policy against such provisions).

exclusively entrusted to the bankruptcy court...."); *Brown v. Gerdes*, 321 U.S. 178, 188 (1944) (the bankruptcy court has "exclusive authority" to determine bankruptcy fees payable out of the estate). Significantly, the Court has refused to enforce "private arrangements" fixing bankruptcy fees that were not even payable out of the estate. See *Leiman v. Gutman*, 336 U.S. at 4, 8. Accord: *In re Kisselberth*, 273 F.3d 714, 718-19 (6th Cir. 2001); *In re Inslaw*, 106 B.R. 331, 333 (Bankr. D.C. 1989) ("In a bankruptcy case fees are not a matter for private agreement."); *In re 5900 Assoc., Inc.*, 468 F.3d 326, 329 (6th Cir. 2006) (The debtor and an attorney "cannot, simply by entering into a state law contract, abridge the court's duty to monitor such fees."); *In re Gulf Hills Dev. Corp.*, 60 B.R. 366, 369 (S.D. Miss. 1985). See also, S. Rep. 95-989, 95th Cong., 2d Sess. 40 (1978) ("In a bankruptcy case fees are not a matter for private agreement.").

E. Section 502(b) Should Be Narrowly Construed In View of The Bankruptcy Code's Distinction Between the Prepetition and Postpetition Periods

The Bankruptcy Code distinguishes between the prebankruptcy and the postbankruptcy periods:

> For more than a century and a half the theory of the English bankruptcy system has been that everything stops at a certain date. Interest was not computed beyond the date of the commission....[T]he rule was laid down not because of the words of the statute, but as a fundamental principle. We take our bankruptcy system from England, and we naturally assume that the fundamental principles upon which it was administered were adopted by us when we copied the system....

Sexton v. Dreyfus, 219 U.S. 339, 344 (1911) (per Holmes, J).

The Bankruptcy Code also structures the date of commencement of a bankruptcy case as a temporal date for the determination of claims against the estate and the scope of property of the estate. See § 502(b), § 503(b) and § 541. Thus, under § 502(b), the amount of every claim must be determined "as of the date of the filing of the petition" commencing the bankruptcy case.

The Bankruptcy Code also divides claims into two categories depending on whether they arose before or after the date of the filing of the bankruptcy petition. The claims of "creditors" are those that arise at the time of or before the commencement of the bankruptcy case.[8] Claims arising after the commencement of the bankruptcy case that provide a benefit to the estate constitute "administrative expenses" of the case under § 503(b), and they are accorded priority of distribution under § 507(a)(2) because they benefit the estate by enabling the debtor in possession or the trustee to administer the estate, and to operate the debtor's business.

The determination and allowance of claims as of the filing date, with payment as administrative expenses only for expenditures benefiting the estate during its administration, is fundamental to the bankruptcy system. See *Matter of Brints Cotton Marketing, Inc.*, 737 F.2d 1338, 1342 (5th Cir. 1984) (A creditor cannot "improve his position viz-a-viz other creditors by action taken by him post-petition," citing *Sexton v. Dreyfus*, 219 U.S. 339 (1911)). See also, *In re Sakowitz, Inc.*, 110 B.R. 268, 271 (Bankr. S.D. Tex. 1989) (disallowing

---

[8] Under § 101(10), a "creditor" is defined as an entity whose claim against the debtor arose at the time of or before the "order for relief" in the case; and under § 301(b), the commencement of a voluntary bankruptcy case constitutes an order for relief in the case. In an involuntary bankruptcy case, if the petition is not dismissed after trial, the bankruptcy court enters an order for relief pursuant to § 303(h).

a claim for postpetition legal fees because "Section 502(b) speaks in terms of the proof of claim *as it existed at the time of the filing of the case.")* (Italics in original).

Legal fees incurred by a creditor after the commencement of the bankruptcy case are of the same quality as interest that would otherwise accrue after bankruptcy, and should be disallowed under the fundamental principle adopted by this Court in *Sexton v. Dreyfus* and followed thereafter by the courts.

F. Interpretation of § 502(b) In Light of the Principle of Equality of Distribution For Creditors

A prime policy of the bankruptcy law, established long ago, is "to secure equality among the creditors of a bankrupt." *Boese v. King*, 108 U.S. 379, 385-86 (1883). The Court has continued to apply this policy through the years. See, e.g., *Clarke v. Rogers*, 228 U.S. 534, 548 (1913); *Young v. Higbee*, 324 U.S. 204, 210 (1945); *Union Bank v. Wolas*, 502 U.S. 151, 161 (1991). This policy was carried into the Bankruptcy Code by § 1123(a)(4), which requires that a chapter 11 plan provide "the same treatment for each claim ...of a particular class."

Indeed, Petitioner recognizes this basic bankruptcy policy, Pet. Op. Br., p. 45,[9] but contends that equality is served by allowing creditors with provisions for attorneys' fees to increase their claims by adding postpetition fees to their claims. The cases it cites for this proposition are inapposite because they concern either a secured creditor, or an unsecured creditor who obtained a judgment against the debtor *personally* on a debt found to be non-dischargeable

---

[9] Citations in this form are to pages of Petitioner's opening brief.

pursuant to § 523(a).[10] Secured creditors are entitled to look to their collateral for the payment of their claims in priority to the unsecured creditors, and their rights to collect interest and legal fees up to the limit of their collateral value is the exception that underscores the rule. Only "to the extent" of that collateral value do secured creditors receive that special right to collect interest and attorneys' fees. This principle was thoroughly analyzed in *Timbers of Inwood*, 484 U.S. at 373. With regard to unsecured creditors' claims, the six decisions by courts of appeals relied upon by Petitioner, Pet. Op. Br., p. 25,[11] are also inapposite. In each of those cases, the judgment in favor of the creditor was on a debt excepted from the debtor's discharge under § 523(a). Significantly, such a judgment is *not* granted against the debtor estate, but only against the debtor *personally*. The creditor's legal fees allowed in each of those cases was thus borne solely by the debtor personally, not by the debtor estate or the other creditors.

If the debtor estate is required, predicated on a contract clause, to bear the legal fees incurred by an unsecured creditor during the bankruptcy, that creditor would in actuality be preferred over other unsecured creditors, particularly those who become unsecured creditors *involuntarily*, such as the holders of tort claims for personal injuries, or of claims for non-priority federal, state or local

---

[10] See § 523 (a), which sets forth 19 particular types of debts of an individual debtor that are excepted from such debtor's discharge in bankruptcy.

[11] *Alport v. Ritter* (*In re Alport*), 144 F,3d 1163, 1168 (8th Cir. 1998); *Davidson v. Davidson* (*In re Davidson*), 947 F.2d 1294, 1297-98 (5th Cir. 1991); *Transouth Fin. Corp. of Fla. V. Johnson* , 931 F.2d 1505, 1507 (11th Cir. 1991); *Jordan v. Southeast Nat'l Bank*, 927 F.2d 221, 227 (5th Cir. 1991); *Martin v. Bank of Germantown* (*In re Martin*), 761 F.2d 1163, 1168 (6th Cir. 1985); *Worthen Bank & Trust Co. v. Morris* (*In re Morris*), 602 F.2d 826, 828-29 (8th Cir. 1979).

taxes. None of the involuntary unsecured creditors could have negotiated before bankruptcy for provisions allowing legal fees they might incur in a subsequent bankruptcy. Moreover, many trade creditors and suppliers who operate small businesses lack sufficient bargaining power to obtain contracts affording them coverage for their legal fees incurred in a subsequent bankruptcy. If such postpetition fee claims are allowed, many unsecured creditors would not be on an equal footing with those who have the prepetition ability and leverage to obtain fee-shifting clauses. The principle of the bankruptcy law for equality of treatment for unsecured creditors thus requires the disallowance of Petitioner's claim.

Petitioner calls on equity to support its effort to gain more than the other general creditors. Pet. Op. Br., p. 49. Rather, equity calls for the disallowance of Petitioner's claim so as to avoid conferring a postpetition benefit on it that other creditors, whose claims do not arise under contracts, could never obtain. See *Pepper v. Litton*, 308 U.S. 295, 305 (1939) ("Equitable powers are to be exercised on the allowance of claims....").

II. CONGRESS COULD NOT HAVE INTENDED TO ALLOW UNSECURED CREDITORS' CONTRACT CLAIMS FOR POSTPETITION LEGAL FEES IN LIGHT OF THE SEVERE ADVERSE CONSEQUENCES SUCH ALLOWANCE WOULD HAVE ON THE ADMINISTRATION OF CHAPTER 11 AND CHAPTER 13 CASES

A. Allowing Such Claims Would Cause Unwarranted Escalation of Monitoring Activities By Individual Creditors and Mounting Expense for the Estate

If the Court were to sustain such legal fee claims, its decision will alert lenders and others who extend credit to

focus on the need to include or revise the fee-shifting clauses in their standard forms of contracts. Such a rule will likely result in the prevalent use of fee shifting clauses in prepetition contracts and a vast increase in the number of such claims, which could overwhelm the administration of bankruptcy cases. It can be expected that all parties who extend credit will write clauses broadly providing for charging all legal fees of *every* kind they incur in connection with a later bankruptcy case. It is also likely that such claims will be routinely filed even in the absence of any dispute over the unsecured creditor's underlying substantive claim and thus no need for legal representation to establish such claim. As predicted by the court in *In re Sakowitz, Inc.*, 110 B.R. at 275, "Each creditor might send an attorney to every hearing in the case."

Accordingly, such a rule will lead to escalating and often unnecessary legal fees being imposed on the estate in chapter 11 cases at the expense of all of the other creditors, who, through the estate, are already bearing the fees of the attorneys for the official creditors' committee for serving *all* of the creditors. See Kenneth N. Klee and K. John Shaffer, *Creditors' Committees Under Chapter 11 of the Bankruptcy Code*, 44 S. Carolina L. Rev. 995, 997 (1993) (discusses the role, functions and operation of official creditors' committees in chapter 11 cases). The official creditors' committee participates in the numerous bankruptcy-specific proceedings that are conducted during chapter 11 cases, and is specifically required by § 1102(b)(3) to provide access to relevant information to all of the creditors, and gives additional reports and disclosure to the creditors as required by the bankruptcy court. Yet if Petitioner wins the day in this case, bankruptcy estates will be burdened with legal fees that creditors may choose to incur for having their own attorneys monitor and otherwise participate in these proceedings.

Fee-shifting clauses encourage the pursuit of litigation, *Ruckelshaus v. Sierra Club*, 463 U.S. 680, 687 (1983). Chapter 11 is intended to provide a framework for the consensual and cooperative resolution of disputes and the reorganization of the debtor, a purpose that would be undermined by a rule allowing recovery of postpetition legal fees. See *In re Combustion Engineering, Inc.*, 391 F.3d 190, 244 (3d Cir. 2004).

This problem is especially heightened in chapter 11 cases, which are significantly different than conventional two-party litigation in the federal district courts. A chapter 11 case is not litigation between parties as such, but is a forum for the adjudication of numerous bankruptcy-related separate proceedings that affect all unsecured creditors as a group.[12] The effect of the myriad of bankruptcy-related proceedings is generally the same for all unsecured creditors, rather than affecting the rights of particular creditors, and is adequately addressed for unsecured creditors as a group by the attorney for the official creditors' committee. However, bankruptcy attorneys representing creditors in chapter 11 cases tend to participate in such proceedings even though the interests of their clients are not challenged or at risk. It is not uncommon for creditors' attorneys, as here, to inject themselves into proceedings for bankruptcy court approval of disclosure statements pursuant to § 1125 and for confirmation of plans of reorganization pursuant to § 1129.

---

[12] Such bankruptcy-specific proceedings affect the unsecured creditors as a group, and often do not affect the allowance of the individual claims of the creditors. Proceedings of this type arise under § 362(d) (relief from the automatic stay), § 363(b) (sale of assets), § 364 (borrowing money), § 365 (assumption and rejection of executory contracts), § 1104 (appointment of a trustee), § 1113 (rejection of collective bargaining agreements), § 1114 (payment of retiree benefits), and § 1121(d) (changing the debtor's exclusive period to file a chapter 11 plan).

If unsecured creditors are allowed legal fees under contract clauses, it will be necessary for the bankruptcy courts to sort out whether and to what extent such legal services are within the applicable contract clause and to adjudicate the value of unnecessary and duplicative legal services of creditors' attorneys. A rule allowing legal fees of unsecured creditors incurred for their attorneys' appearance at these proceedings would result in a large number of claims aggregating large amounts against the estate, and reduce the distributions from the "pot" that would otherwise be available for all of the unsecured creditors.

Because bankruptcy proceedings are multi-party with shifting alliances, quite different than standard two-party lawsuits, bankruptcy courts may be hard-pressed to evaluate the results achieved by attorneys for unsecured creditors and determine who was the winner. See *Ruckelshaus v. Sierra Club*, 463 U. S. at 684 (after referring to the basic American rule against fee-shifting, stating: "It is clear that generations of American judges, lawyers and legislators...would regard it as quite 'inappropriate' to award the 'looser' an attorney's fee from the 'prevailing litigant.'").

In light of these consequences, Congress could not have intended § 502(b) to be a basis for the allowance of claims by unsecured creditors for postpetition legal fees.

B. Allowing Postpetition Legal Fees to Unsecured Creditors Will Overly Complicate Chapter 11 Cases

The allowance of postpetition legal fee claims to unsecured creditors will overly complicate chapter 11 cases, increase the legal fees the estate must bear, thereby diluting the "pool" of assets available for all other unsecured creditors, and delay their administration and conclusion.

Unsecured creditor legal fee claimants will, as Petitioner did here, increasingly file so-called "contingent" protective claims at the outset of the case. Contingent claims constitute "claims" under the Bankruptcy Code because they are within § 101(5)'s definition of a "claim." At the beginning of a chapter 11 case, when creditors file contingent claims, an unsecured creditor will not know whether, or the extent to which, it will thereafter incur legal fees in the case because it will not know what proceedings will be commenced in the case and whether its claim will be challenged. The contingent claim for future legal fees will thus amount to nothing more than a guess by the unsecured creditor.

To be an allowed claim entitled to vote on a chapter 11 plan and participate in distributions thereunder, however, such contingent claim must be estimated pursuant to § 502(c), or adjudged to be in a particular amount in a litigated proceeding. Section 502(c) requires that an "estimation" proceeding be conducted, at which evidence may be adduced and in which the bankruptcy court makes an educated guess as to the ultimate value of the claim. See *In re Nova Real Estate Inv. Trust*, 23 B.R. 62, 66 (Bankr. D. Va. 1982) ("An estimate necessarily implies no certainty"). Cf. *Dunbar v. Dunbar*, 190 U.S. 340, 345 (1903) (There is an "innate difficulty, if not impossibility, of estimating or valuing" many contingencies). The estimate is made before any legal services of the unsecured creditor's attorney have been rendered and will ascribe value to various possible future proceedings that may never be commenced or disputes involving the unsecured creditor that may never arise. This makes estimation of future legal services in the chapter 11 context a speculative matter. It is thus not a satisfactory process for the allowance of an unsecured creditor's legal fee claim in a chapter 11 case.

On the other hand, the alternative of liquidating the contingent legal fee claim of the unsecured creditor by an adjudication is likewise unattractive. Among other things, it could require the bankruptcy court to conduct several proceedings at different stages of the chapter 11 case in order to determine the total amount to which the creditor would be entitled for its legal fee claim. All of these proceedings would occur in the face of the Court's admonition in *Hensley v. Eckerhart*, 461 U.S.424, 437 (1983), that "A request for attorney's fees should not result in a second major litigation." But that is exactly what may happen if unsecured creditors are allowed postpetition legal fees under contract clauses.

Even if the determination of the amount of an unsecured creditor's claim is not made until later in the case, there may initially be a proceeding by the unsecured creditor to determine the amount of the claim so as to establish its voting rights. The unsecured creditor's attorney will likely thereafter continue to render legal services as the chapter 11 case moves forward to other stages of the confirmation process including among others, proceedings for approval of disclosure statements under § 1125 required for the solicitation of acceptances of the plan and for its confirmation. After the creditor's attorney monitors or otherwise participates in those proceedings, more litigation will be required to determine the amount of the fees to be allowed for that participation. And even that may not be the end of the story. If the proposed plan is not accepted by creditors or is not confirmed for other reasons, still another proposed plan of reorganization will emerge, only to be followed by still another round of fee litigation with the unsecured creditor. All of these proceedings would consume a substantial amount of time of the bankruptcy court as well as for the attorneys for the chapter 11 debtor in possession (or trustee) and for the official creditors' committee, all at the expense of the debtor estate.

Moreover, a rule allowing unsecured creditors' claims for postpetition legal fees may interfere with the formulation on a timely basis of the terms for reorganization by the debtor or another potential proponent of a plan of reorganization. Such terms are formulated in part on the basis of the total amount of all of the claims against the debtor. Information as to the universe of claims against the debtor is thus needed by the debtor and others who seek to pursue reorganization alternatives. The continuous stream of services by unsecured creditors' attorneys throughout the case and the continued accrual of the fees therefor, however, will stand in the way of determining on a timely basis the universe of claims against the debtor.

C. Unsecured Creditors' Legal Fee Claims Should Not Be Allowed Because of the Serious Consequences Allowance Would Have on Chapter 13 Debtors and Their Unsecured Creditors

A rule interpreting § 502(b)[13] to allow postpetition legal fee claims of unsecured creditors under fee-shifting clauses would have a serious adverse effect on chapter 13 debtors, and also on all of their unsecured creditors. Such a rule would also create unmanageable administrative difficulties in computing and making the periodic distributions, usually monthly, of the debtor's "disposable income"[14] to the unsecured creditors pursuant to confirmed chapter 13 plans. § 1325(b)(1)(B). This is because it would

---

[13] Under § 103(a), § 502(b) applies in chapter 13 cases as well as chapter 11 cases.

[14] Section 1325(b)(2) defines "disposable income" as all of the current income monthly income of the debtor (excluding certain support obligations and payments) less amounts reasonably necessary for support of the debtor and dependants, and certain charitable contributions and certain business expenses if the debtor is engaged in a business.

be essential to recompute each creditor's share of such distributions every time that a creditor's attorney renders additional legal services.

The problems caused by the allowance of such claims would be acute in light of the enormous volume of chapter 13 cases. During the 12 months ended June 30, 2006, there were 313,085 chapter 13 filings[15] and thousands more than that number of chapter 13 cases are currently being administered. In light of that high volume, allowing postpetition legal fee claims would be a nightmare in chapter 13 cases, and specifically for chapter 13 trustees, who are the ones who make the payments to the unsecured creditors under the plan pursuant to § 1326(c), and who may be held personally liable for errors in making distributions to the creditors. See *In re Wilson*, 274 B.R. 4 (Bankr. D.C. 2001).

In most districts, a standing chapter 13 trustee is appointed to administer all of the chapter 13 cases in the district, § 1302(a), and the single chapter 13 trustee is thus often responsible for thousands of chapter 13 cases at a time. If unsecured creditors' postpetition fee claims were to be allowed, it would be a virtual impossibility for these chapter 13 trustees to make the periodic recomputations of claims and distributions to creditors on a timely basis, and it could be necessary to defer distribution to creditors for five years until the end of a chapter 13 case, § 1322(d), instead of much earlier periodic distributions in chapter 13 cases.

Moreover, the Court should not adopt a rule allowing postpetition fee claims by unsecured creditors because it would operate against the interests of both the chapter 13

---

[15] This number was compiled by the Administrative Office of the United States Courts. See http://www.uscourts,gov/bnkrpctystats/bankrupt_f2table_jun2006.xls.

debtor and all of the debtor's unsecured creditors. First, chapter 13 debtors often need to retain their automobiles to get to and from work. Over 77% of workers in America use their cars for that purpose.,[16] and given the dependence on cars for getting to work, making cars a vital component of gaining a "fresh start." See Keith M. Lundin, *Chapter 13 Bankruptcy* § 518.1 (3d ed. 2006). In order to retain his or her car, § 1325(a)(5)(B) requires a chapter 13 debtor to pay the holder of a purchase money lien securing the vehicle the full amount of "the underlying debt determined under nonbankruptcy law" if such debt arose within 910 days before the bankruptcy filing and the car was acquired for personal use.[17] See *In re Fleming*, 339 B.R. 716, 722 (Bankr.E.D. Mo. 2006) (stating that it is irrelevant that the value of the collateral is less than the underlying debt); *In re Johnson*, 337 B.R. 269, 272-73 (Bankr. M.D.N.C. 2006); *In re Ezell*, 338 B.R. 330, 340-41 (Bankr. E.D.Tenn. 2006); *In re Brown*, 346 B.R. 868, 876 (Bankr. N.D.Fla. 2006). If, as in many chapter 13 cases, the lienholder's claim is more than the value of the car, the debt to such undersecured creditor would, if such rule is adopted, include unsecured postpetition legal fees as part of the "underlying debt." This will make it more difficult for the debtor to be able to retain the car, because to do so, the financially embarrassed debtor will have to come up with even more cash to cover the legal fees as part of the underlying debt to the vehicular financier, or loose the car. This could impair the debtor's "fresh start,"

---

[16] U.S. Census Bureau, 2005 American Community Survey, http://factfinder.census. Gov/servlet/STTable

[17] The so-called "hanging paragraph" of §1325(a), which immediately follows the first sentence of § 1325(a)(9), makes § 506(a), which reduces the secured portion of an undersecured claim to the value of the collateral, inapplicable to the determination of the amount of the"underlying debt" for the purpose of § 1325(a)(5) if the debt arose within 910 days before the bankruptcy filing and the car was acquired for the debtor's personal use.

which is a main purpose of the bankruptcy law. See *Burlingham v. Crouse*, 228 U.S. 459, 473 (1913); *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934).

There is another compelling reason for the disallowance of such claims. The obligation to pay such car lenders more than their collateral value was enacted in 2005 as part of the Bankruptcy Abuse Prevention and Consumer Protection Act. That Act significantly amended both chapter 7 governing liquidation proceedings, in which unsecured creditors rarely receive any distribution from the individual debtor's chapter 7 estate, and chapter 13, under which unsecured creditors are likely to receive periodic distributions under confirmed plans. Congress' purpose was to ensure that unsecured creditors of individual debtors seeking bankruptcy relief would receive distributions from the debtors' post-petition wages. Cf. *In re Meza*, 467 F.3d 874, 877 (5th Cir. 2006) (Chapter 13 enables individual debtors "to amortize their debts out of future earnings," and "permits wage-earning debtors 'to reorganize with a repayment plan as an alternative to seeking a complete discharge of debts through the chapter 7 bankruptcy liquidation process.'"). To accomplish that objective, Congress restructured chapter 7 to require the dismissal of an individual debtor's chapter 7 case unless the debtor's monthly income is less than the statutory level, which § 707(b)(2) fixes at a relatively low amount. This makes chapter 7 unavailable to many individual wage earners, and leaves as their only bankruptcy alternative a proceeding under chapter 13, which, to accomplish Congress' purpose, requires the distribution of *all* of the debtor's "disposable income" to his or her unsecured creditors during the multi-year life of a chapter 13 plan. See *In re Fuller*, 346 B.R. 472, 484 (Bankr. S.D. Ill. 2006); *In re Fuger*, 347 P.R. 94, 99 (Bankr. D. Utah 2006).

The allowance of postpetition legal fee claims would result in a significant reduction in the amount of the chapter 13 debtor's "disposable income" and thus in a dollar for dollar reduction in the distributions targeted by Congress for the unsecured creditors in chapter 13 cases. This is because the allowance of postpetition legal fees to an *undersecured* creditor, which must be paid by a chapter 13 debtor to retain his or her car, would reduce the debtor's "disposable income" and thereby reduce the amount distributable to all of the other unsecured creditors. Moreover, the allowance of postpetition fee claims of *wholly unsecured* creditors would itself increase the aggregate amount of all unsecured claims, thereby diluting every unsecured creditor's *pro rata* share of all distributions of the debtor's "disposable income."

A rule allowing unsecured creditors' postpetition legal fee claims would not only be administratively unmanageable, but also would be harmful to the unsecured creditors.

CONCLUSION

For the foregoing reasons, the order appealed from disallowing Petitioner's claim should be affirmed.

Respectfully submitted,

ROBERT M. ZINMAN
Professor of Law
St. John's University School of Law
8000 Utopia Parkway
Jamaica, New York 11439
(718) 990- 6646, or
(914) 631-3515
Counsel of Record for *Amici Curiae* Professors

Of Counsel:

Richard Corbi
Daniel J. Morse

December 22, 2006